

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Savannah Division

IN RE:)	Chapter 7 Case
)	Number <u>85-40555</u>
DIAMOND MANUFACTURING)	
COMPANY, INC.)	
)	FILED
Debtor)	at 9 O'clock & 00 min. A.M.
		Date: 3-20-90

ORDER

Chapter 7 Trustee, W. Jan Jankowski, filed with this court on September 14, 1989, a motion to approve a compromise and determine extent and validity of liens against proceeds of a judgment awarded to debtor, Diamond Manufacturing Company, Inc., against W. F. Magann Corporation and Aetna Casualty and Surety Company (hereinafter "Magann").¹ By order of October 19, 1989, this court approved the compromise in the sum of One Million Seven Hundred Thousand and No/100 (\$1,700,000.00) Dollars, but made no determination as to the extent and validity of liens asserted by various claimants. All interested parties were provided an

opportunity to brief their positions on claims and liens to the court. After consideration of those arguments and the record of this case, the court makes the following findings of fact and conclusions of law.

¹A proceeding to determine the validity, priority, or extent of a lien or other interest in property usually must be brought in the form of an adversary proceeding. Bankruptcy Rule 7001. However, the parties have agreed to allow this determination to be made by the court from the trustee's motion now under consideration.

FINDINGS OF FACT

1. In February, 1985, the United States District Court for the District of South Carolina, Charleston Division, entered a judgment in the principal amount of Nine Hundred Thousand and No/100 (\$900,000.00) Dollars in favor of debtor and against Magann. Magann appealed the judgment to the Fourth Circuit Court of Appeals.

2. Debtor executed on February 8, 1985, an agreement in which a portion of the judgment against Magann was assigned to Liberty Mutual Insurance Company (hereinafter Liberty Mutual) after the United States District Court for the Southern District of Georgia, Savannah Division, entered judgment in the principal amount of Two hundred Forty-Four Thousand Six Hundred Ninety-Eight and No/100 (\$244,698.00) Dollars against the debtor and in favor of Liberty Mutual.

3. Debtor filed for protection under Chapter 11 of the Bankruptcy Code on August 29, 1985. The case was converted to a case under Chapter 7 by order of this court on August 26, 1988.

4. The debtor was represented in the Magann litigation by the law firm of Lewis, Babcock, Pleicones, & Hawkins which was

approved as counsel for the debtor by the Bankruptcy Court. By order of this court entered October 17, 1989, this firm was awarded Three Hundred Twenty-Thousand Two Hundred Ninety-Two and 17/100 (\$320,292.17) Dollars in attorneys fees from the Magann settlement proceeds.

5. In 1981, prior to the debtor seeking the protection of this court, Debtor's President and Chief Executive Officer, Donald E. Austin, agreed orally to compensate attorney William H. Moore, Jr. in some "reasonable" amount for any work expended by Mr. Moore on the litigation against Magann. Mr. Moore asserts an attorney's lien against the settlement proceeds, but no written fee agreement was entered into by the debtor and Mr. Moore.

6. Bernard E. Hirsch, a certified public accountant, filed a claim against the Magann settlement proceeds in the amount of Five-Thousand

Three Hundred and No/100 (\$5,300.00) Dollars. No written agreement was entered into by the debtor and Mr. Hirsch for accounting services.

7. Debtor's President and Chief Executive Officer, sole shareholder, and a member of the bar of this court, Donald E. Austin, asserts he is entitled to a portion of the Magann proceeds for legal work he did on behalf of the debtor and asserts an attorney's lien against the proceeds of the Magann settlement.

8. Attorney, George N.P. Pahnó, represented the debtor in the debtor's Chapter 11 proceedings before this case was

converted to a proceeding under Chapter 7 of the Bankruptcy Code. Mr. Pahnó represented the interests of the debtor-in-possession in the Magann litigation, and asserts an attorney's lien against the settlement proceeds for legal work done on behalf of the debtor-in-possession in the Magann litigation. Mr. Pahnó was never appointed by this court as the attorney for the debtor-in-possession as no application for such an appointment was ever filed. Mr. Pahnó, however, appeared and represented the debtor-in-possession at all proceedings prior to conversion.

9. The debtor was engaged in the business of designing, building and repairing metal fabrications for bridges, stadiums and tide gates and equipment such as barges, tugs, cranes, and offshore towers. The debtor, along with Chapter 7 debtor, Rose Marine, Inc. and Chapter 11 debtor-in-possession Donald E. Austin, owns a substantial amount of marine construction equipment which has been valued at One Million Seven Hundred Thirty-Four Thousand Eight Hundred Sixty-Seven and No/100 (\$1,734,867.00) Dollars. In re: Diamond Manufacturing Co. Inc., Chapter 11 Case No. 485-00555 (Bankr. S.D. Ga. filed Aug. 26, 1988). In addition, the debtor owns certain tracts of undeveloped real estate which has been valued by this court at Two Million Two Hundred Forty-Seven Thousand Five Hundred and No/100 (\$2,247,500.00) Dollars. The debtor also possesses a leasehold interest in port space at the harbor in Savannah, Georgia, and a leasehold interest in an office building

in Savannah, Georgia.

10. Signet Commercial Credit Corporation (hereinafter "Signet") is the principal secured creditor in the debtor's bankruptcy case, having submitted a proof of claim on November 23, 1988, in the case for Four Million Four Hundred Eighty-Five Thousand Three Hundred Twenty-Five and 95/100 (\$4,485,325.95) Dollars. This court found Signet's claim against the debtor as of May 31, 1988, to be Three Million Five Hundred Thirty-Seven Thousand Eight Hundred Fifty-Five and 34/100 (\$3,537,855.34) Dollars. In re: Diamond Manufacturing Co., Inc., supra.

11. By order of the Honorable Herman Coolidge, former judge of this court, the debtor was ordered to make adequate protection payments to Signet in the sum of Thirty-Two Thousand and No/100 (\$32,000.00) Dollars per month for six months and to reduce its indebtedness to Signet by not less than twenty-seven (27%) percent by December 31, 1987. In re: Diamond Manufacturing Co., Inc., Chapter 11 Case No. 485-00555 (Bankr. S.D. Ga. filed April 20, 1987). This order awarding Signet adequate protection payments was appealed by the debtor and has been remanded to this court for further consideration. The debtor complied for four months with the order to make the adequate protection payments.

CONCLUSIONS OF LAW

Signet seeks to have all of the settlement proceeds held by the trustee until the final disbursement in the case contending that it may be entitled to a superpriority administrative expense claim if the adequate protection awarded it by the court prior to the conversion of the debtor's case to one under Chapter 7 of the Bankruptcy Code is subsequently determined to be inadequate to secure their claim

pursuant to 11 U.S.C. §507(b).² Section 507(b) creates a superpriority for payment of creditor's claims for administrative expenses under section 503(b) (1) (A)³ due to the

failure of court awarded adequate protection. The use of a creditor's collateral by a debtor-in-possession for the benefit of the estate creates a claim for an administrative expense under section 503(b). In re: Callister, 15 B.R. 521, 525 (Bankr. D. Utah, 1981). "Presumably such use is desired by the debtor and is contributing to the reorganization effort. Otherwise, the debtor would doubtless return the collateral and forego providing adequate protection. This beneficial use by the debtor is normally 'paid for' by the adequate protection. Where adequate protection becomes inadequate or otherwise fails and the use nonetheless continues,

²11 U.S.C. §507(b) provides:

If the trustee under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a) (1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

³11 U.S.C. §503(b) (1) (A) provides in relevant part:

After notice and a hearing, there shall be allowed administrative expenses, . . . , including

(1) (A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries or commissions for services rendered after the commencement of the case.

section 507(b) comes into play by covering the creditor's unprotected interest by according it priority administrative expense status." In re: Mutschler, 45 B.R. 494 (Bankr. D.N.D. 1984). Every decline in value of a creditor's collateral is not entitled to be recompensed as a priority administrative expense, but only that decline in value which is directly attributable to the automatic stay of section 362 or the use of the collateral by the debtor-in-possession. In re: Alyucan Interstate Corp., 12 B.R. 803, 808 (Bankr. D. Utah 1981); In re: Falwell Excavating Co., 47 B.R. 217 (Bankr. W.D. Va. 1985).

However, the court need not determine whether Signet is actually entitled to such a claim at this point. Signet has presented no evidence that the adequate protection it received from the debtor has proved inadequate. Signet holds a security interest

in real property owned by the debtor which this court has valued at Two Million Two Hundred Forty-Seven Thousand and No/100 (\$2,247,000.00) Dollars and in equipment which this court has valued at One Million Seven Hundred Thirty-Four Thousand Eight Hundred Sixty-Seven and No/100 (\$1,734,867.00) Dollars. The debtor also holds a leasehold interest in an office building and in port space at the harbor in Savannah, Georgia, in which Signet holds a security interest. Although the value of the equipment in which Signet held a security interest was depreciating at the time of the award of adequate protection payments and at the conversion of the case, no evidence was presented to show that the undeveloped real property or the leasehold interests were less valuable. This additional collateral could prove adequate to protect Signet's interest in the depreciating equipment. Therefore, no basis exists on which to find that Signet's adequate protection awarded by this court was inadequate. In addition, Signet only seeks at this time an order requiring the Chapter 7 trustee to retain the Magann settlement proceeds until the final disbursement of estate funds. However, no basis exists to enter such an order.

Signet has made no showing that there exists a substantial likelihood that

estate funds will be insufficient to pay all administrative claims in full. Section 507(b), by its terms, will only be considered if the funds of the estate are insufficient to pay all claims for administrative expense. No evidence indicates that claims for administrative expenses will exceed the available assets even if Signet should be entitled to a priority administrative expense claim. Therefore, no cause exists to withhold appropriate disbursement of the Magann settlement proceeds until all of the debtor's remaining assets are liquidated.

Having determined that disbursement of the settlement proceeds is appropriate, the court's attention must turn to the parties claiming to be entitled to such distribution. Liberty Mutual contends that it is entitled to a portion of the proceeds because the debtor assigned a portion of the Magann judgment to it. The alleged assignment of a portion of the Magann judgment occurred after Liberty Mutual received a judgment against the debtor from the District Court. The written assignment between Liberty Mutual and the debtor provided that "the claim of Diamond Manufacturing Company, Inc. against W. F. Magann Corporation and Aetna Casualty & Surety Company arising from a judgment obtained by Diamond against Magann and Aetna . . . [was] assigned, transferred and set over" to Liberty Mutual. The agreement continues, "the purpose of this assignment is to secure the judgment obtained by Liberty Mutual [against Diamond] . . . in the sum of Two Hundred Forty-Four Thousand Six Hundred Ninety-Eight and No/100 (\$244,698.00) Dollars." The assignment also provides that Liberty Mutual would be paid first an amount sufficient to satisfy the judgment held by it and all interest thereon with only attorney's fees having a prior lien.

Liberty Mutual contends that this assignment of a judgment is not subject to the secured transactions provisions of the Uniform Commercial Code (UCC) as the article does not apply to a right represented by a judgment or to a transfer in whole or in part of any claim arising out of tort. The trustee and Signet object to the assignment of the judgment to Liberty Mutual contending that the UCC provisions on secured transactions do apply, and the security interest of Liberty Mutual in

the judgment was never perfected.

The parties agree that the laws of the jurisdiction in which the debtor is located, i.e. Georgia, governs whether Liberty Mutual was required to perfect its security interest in the judgment.⁴ Georgia's commercial code provides that the secured transactions article shall not apply "to a right represented by a judgment" or "[t]o a transfer in whole or in part of any claim arising out of tort." O.C.G.A. §11-9-104(b), (i). Liberty Mutual contends that because judgments and tort claims are excepted from the secured transactions provisions of the UCC, no perfection of its interest in the Magann judgment was required.

While the assignment of a tort claim may be excepted from the requirement of perfection under the UCC, Liberty Mutual was not actually assigned an interest in the tort claim against Magann, but

rather attempted to obtain a security interest in the judgment awarded the debtor by the court in the Magann litigation. Any tort claim the debtor had against Magann had been reduced to judgment and no longer fell within this exception of the UCC.

A "right represented by a judgment" is excluded from coverage under the UCC. O.C.G.A. §11-9-104(i). The right of Liberty Mutual represented by the judgment it had obtained against the debtor, therefore, would be excluded from coverage under the UCC. The right of the debtor represented by the judgment against Magann would also be excluded under the secured transactions provisions of the UCC. If Liberty Mutual had obtained a complete assignment of the debtor's judgment against Magann, such an assignment may very well have been excluded under the UCC. Liberty Mutual, however, did not receive an assignment of the Magann judgment, but rather attempted to obtain a security interest in the judgment to secure payment of the judgment it had obtained against the debtor. "An assignment, unlike a lien, is not merely a charge upon the subject property but is

⁴All references to the secured transactions provisions of the UCC shall be to the provisions as enacted in Georgia. See O.C.G.A. §11-9-101 to 507.

an absolute, unconditional, and completed transfer of all right, title, and interest in the property that is the subject of the assignment (whether in the property as a whole or a specified estate in or portion of the property), with the concomitant total relinquishment of any control over the property." Bank of Cave Spring v. Gold Kist, 173 Ga. App. 679, 327 S.E. 2d 800 (1985). The debtor did not relinquish control over any

portion of the litigation against Magann, but rather continued to control the litigation. Essentially, the debtor allowed Liberty Mutual a charge against the expected recovery from the judgment, but assigned no portion of any expected recovery to Liberty Mutual. Liberty Mutual attempted to take a security interest in the expected recovery from the judgment, not an assignment of the judgment.

The purported assignment executed by the debtor and Magann provides that, "The purpose of this assignment is to secure the judgment obtained by Liberty Mutual . . . against Diamond in the sum of Two Hundred Forty-Four Thousand Six Hundred Ninety-Eight and No/100 (\$244,698.00) Dollars." In order to perfect such a security interest, Liberty Mutual would be required- to comply with the secured transactions provisions of the UCC. While a right represented by a judgment may be excluded from such requirements, Liberty Mutual has no right represented by a judgment in the Magann proceeds. Liberty Mutual was not a party to the Magann litigation and did not receive a true assignment of the judgment. Liberty Mutual only attempted to gain a security interest in the debtor's right to recovery represented by the judgment, and to perfect such , an interest, Liberty Mutual would be required to comply with the i UCC. "The application of . . . article [9 of the UCC] to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which . . . article [9] does not apply." O.C.G.A. §11-9-102(3).

The debtor's right represented by the judgment against Magann would be excluded under the UCC, but Liberty Mutual's effort to gain a security interest in that right would be within the scope of the UCC. Liberty Mutual would be required to file a

financing statement under the UCC to perfect such a security interest, O.C.G.A. §11-9-302, and Liberty Mutual made no effort to perfect its security interest in the debtor's right represented by the judgment against Magann.

Liberty Mutual holds nothing more than an unperfected security interest in the Magann judgment and as such is not entitled to payment from the settlement proceeds. "[A]n unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor before the security interest is perfected." O.C.G.A. §11-9-301(1)(b). A lien creditor would include the trustee in bankruptcy. O.C.G.A. 11-9-301(a); 11 U.S.C. §544. Liberty Mutual's rights in the settlement proceeds, therefore, would be subordinate to the rights of the bankruptcy trustee, and the bankruptcy trustee could avoid Liberty Mutual's claim to the settlement proceeds. See 11 U.S.C. §544; McDaniel v. American Druggists' Insurance Co. (In re: National Buy-Rite), 6 B.R. 102 (Bankr. N.D. Ga. 1980). Liberty Mutual is the holder of an unsecured claim which must await payment until the final distribution of the estate funds by the trustee.

Certified Public Accountant, Bernard E. Hirsch, asserts

that he has a lien against the settlement proceeds for accounting services performed for the debtor in relation to the Magann litigation. No written agreement was entered into by the debtor and Mr. Hirsch. No evidence that the work performed by Mr. Hirsch was on behalf of the bankruptcy estate has been presented and no evidence of when Mr. Hirsch was retained by the debtor has been presented. Mr. Hirsch filed no brief in support of his claim, and the court can find no basis to support Mr. Hirsch's claim to a lien on the settlement proceeds. Therefore, the claim of Mr. Hirsch to a portion of the Magann settlement proceeds must be denied.

In addition, attorneys, William Moore and George Pahnó, assert attorney's liens against the proceeds of the Magann settlement. Debtor's chief executive officer, only shareholder, and a member of the bar of this court, Donald Austin, also asserts an attorney's lien against the settlement proceeds for legal work

allegedly done on behalf of the debtor regarding the Magann litigation. No written fee agreement was entered into by the debtor and Moore, Pahno, or Austin as attorneys for the debtor. However, while this motion now before the court was being considered by the court, attorney William Moore, by and through his counsel, filed on February 23, 1990, a motion he entitled "Petition to Enforce Compromise Settlement by Trustee and For Approval of Same by the Court." In the motion, Mr. Moore alleged that the trustee had agreed to settle the claims of Pahno, Austin, and Moore to the

settlement proceeds for amounts set forth in the motion. The motion has been set for hearing on April 17, 1990, in Savannah, Georgia, and the court will withhold ruling on the claims of Pahno, Austin, and Moore until consideration of Moore's motion alleging that the trustee agreed to compromise their claims.

For the above stated reasons, it is hereby ORDERED that the objection of Signet to the distribution of the settlement proceeds is denied;

Further ORDERED that the claim of Liberty Mutual to a portion of the Magann settlement proceeds is denied;

Further ORDERED that the claim of Bernard Hirsch to a portion of the settlement proceeds is denied; and

Further ORDERED that the validity of the claims of Austin, Pahno, and Moore shall be considered subsequent to the resolution of Mr. Moore's motion to enforce compromise of their claims.

JOHN S. DALIS
UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia
this 19th day of March, 1990.